NOTES

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> The objects of the Association shall be to assist in the development and to increase the usefulness of the Columbia University Law Library, by the following and other means which may be suggested from time to time:
>
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>
> (b) By the payment of annual dues, and the creation of a Columbia University Law Library Association Fund.
>
> (c) By encouraging donations of books and collections of books to the Library.
>
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HOW SHOULD "REASONABLE RENT" UNDER THE NEW YORK HOUSING LAWS BE CALCULATED?—The question, left unsettled by the Housing Laws,[1] as to what is a reasonable rent and what factors are to be considered in determining it, is of peculiar interest as it furnishes a striking example of a case where the determination of a question of law is purely one of economics. Usually, however, a mass of formal legalistic doctrines must be cleared away before the root of the matter is reached, while here the real question is immediately presented. As the question is economic, the sound result can only be reached by treating it as such. The object of the Housing Laws is to obtain for the tenant the best accommodations at the most reasonable rate which will attract capital to the business. Recent cases in the lower New York courts, which deal with the method of determining this rate, are in hopeless conflict. They disagree as to the base upon which the rent should be figured.[2] All three possible bases have been taken; the owner's equity,[3] his

[1] N. Y., Laws 1920, c. 944.

[2] To illustrate the problem, suppose A owns a $100,000 apartment house on which he paid $20,000 and gave a mortgage for $50,000. The reasonable value is $100,000, the investment $20,000, and the capital $50,000. Now, if a fixed rate is taken, say 10%, and then the base determined there will be a very material difference in result varying with the base chosen. If we use the reasonable va'ue, the owner's return will be $10,000; if the investment, $2,000; if the capital, $5,000. The more sensible way of approaching the problem is to determine the base and then fix the rate according to which base is taken. What is a reasonable rate is not discussed in this note. However, it is suggested that the lowest rate which will attract capital to the housing business is the reasonab'e rate.

[3] *Miller* v. *Avon* (Sup. Ct. App. Term, 1st Dept. 1921) 188 N. Y. Supp. 457; *Kaufmann* v. *Bielsky* (Sup. Ct. App. Term, 1st Dept. 1921) 188 N. Y. Supp. 832 (*semble*).

investment,[4] and the reasonable value of the property.[5]

First, let us consider upon what, in the general course of business, profits are figured. It is not on the total value of the property nor on the investment, but upon the capital.[6] This is well illustrated by the method of keeping books. Suppose A owns an apartment house worth $100,000 on which he has a $60,000 mortgage. On his books under the heading "Property," $100,000 is entered, under "Mortgage," $60,000 and under "Capital," $40,000. It is upon this last item, the equity, that the owner calculates the return on his business. Consequently, it seems that this is the natural base for the court to take.

Next, let us consider the investment. If this were taken as the base, several serious difficulties would arise. In the first place, the owner would be deprived of one of the incidents of property which every purchaser of real estate considers in buying, the possibility that the value of the property will increase. In the case of one who has owned property for several years, this might be a very material amount. Of course the result of all regulation is to injure values. The question here is, to what extent did the legislature intend to injure values? The rent laws are defensive measures designed to meet the present crisis by preventing further increase, rather than by diminishing values which existed at the time of their enactment. This is shown by the fact that courts have held them not applicable to leases made prior to the date they became effective.[7] This seems a reasonable interpretation, particularly in view of the fact that no specific statement to the contrary is made in the act.

There is a further difficulty caused by taking the investment as a base. Suppose A, B and C each own one of three identical apartment houses of the same present value. A bought his for $70,000, B his for $100,000 and C his for $160,000. Each gave a mortgage for $40,000 and paid the balance in cash. At any uniform rate, C would receive four times as much as A and twice as much as B. One might say that all three were treated fairly because they all received the same percentage on each dollar originally invested. But suppose $100,000 is the reasonable value of each house. A purchaser of real estate expects to have the gain caused by a rise in value and also to stand the losses caused by depreciation. Hence here all parties alike would expect a return on $60,000. This result would likewise seem desirable from the tenants' point of view. In each house there are identical apartments; but if we take the investment as the base the rent would vary in the same proportion that one investment is greater than another. This would be no argument against applying the rule in the cases of A and B if they, the landlords, were not unjustly treated. In C's case, however, the tenants would be forced to pay a return on C's loss. To make all pay rent on $60,000 would not be unfair as each would then have the same thing at the same price.

Let us again consider the equity as a possible base. If we take a fixed rate, the net rental will vary with the amount of the equity,—the larger the equity the greater the rent. For example: A and B own identical apartment houses each worth $100,000. A has given a mortgage of $50,000 while B has given one of

[4] *Hall Realty Co.* v. *Moos* (Sup. Ct. App. Term, 1st Dept. 1921)) 115 Misc. 506, 188 N. Y. Supp. 858. The same court on the same day apparently held that the rent could be allowed on the value of the property. It does not appear, however, whether the question of allowing it on the equity was presented or whether the landlord had paid full value. *Sperling* v. *Barton* (Sup. Ct. App. Term, 1st Dept. 1921) 188 N. Y. Supp. 857.

[5] *Hirsch* v. *Weiner* (Sup. Ct. App. Term, 2d Dept. 1921) 116 Misc. 312, 190 N. Y. Supp. 111.

[6] The terms "capital" and "equity" are used in this note interchangeably.

[7] *Orinoco Realty Co.* v. *Bandler* (App. Div., 1st Dept. 1921) 189 N. Y. Supp. 855; *1200 Madison Ave. Corp.* v. *Merrils* (Sup. Ct. App. Term, 1st Dept. 1921) 189 N. Y. Supp. 110; *810 West End Ave., Inc.* v. *Herzog* (Sup. Ct. App. Term, 1st Dept. 1921) 189 N. Y. Supp. 11.

$60,000. Take 20% as the reasonable rate. The tenants in A's house will have to pay $2,000 more than those in B's for exactly the same accommodation. Again suppose that C has been successful in mortgaging his property to its full value. His tenants will have to pay only the cost of operation. Under ordinary circumstances, competition will take care of this, since neither will be able to charge a greater rent than the other. If one man has more capital in his house than is usual in the business, he will be forced to mortgage his property to a greater extent so as to release part of his money for other ventures. Otherwise, he must be satisfied with a lower rate on his capital. From general business experience, a certain ratio can be determined at which capital and mortgage can be combined to get the most efficient service at the lowest cost. It is not straining the meaning of the Housing Laws to hold that reasonable rent means a rent figured under the most efficient method of conducting the business. This ratio at which mortgage and capital can be most effectively employed is a question of fact. Then, in determining the reasonable rent, the equity should only be considered up to the extent fixed by this ratio. On all of the equity above that amount, the owner should be allowed only the same rate at which he can borrow money on a mortgage. If his equity is less, he should be able to get a return on an amount up to that fixed by the ratio, because it was his ability that secured the added loan and he should have the benefit of it. For illustration, suppose A, B and C each own identical apartment houses valued at $100,000. A has mortgaged his at $50,000, B his at $70,000 and C his at $40,000. Take 5:5 as the proper ratio and the rate as 20%. A will get $10,000, B $10,000 plus 6% on $20,000, the rate at which he could borrow money on a mortgage, or $1200, making a total of $11,200, and C $10,000. This rule also has the advantage that all tenants pay the same rent,—$10,000, plus 6% on $50,000, plus the operating expenses.[8]

Now, let us consider the reasonable value of the property as a base. As has been pointed out, it is not upon this that the average man figures his return. Although it is not the most natural base, we may use it and arrive at the same result as by using the equity. However, a different rate must be fixed. Take the last case stated above. The net income plus the interest in all three cases amounts to $13,000. This would equal 13% on the reasonable value. Using this and not allowing the owner to deduct the interest on the mortgage, each will get the same return as though the equity was used as the base. This method of computing, once the rate has been fixed, has the virtue of simplicity.

This raises the question of reasonable value. If we take market value as the reasonable value we are arguing in a circle because market value depends almost entirely upon what the property will bring in rents. If this return is unreasonable, the value will be unreasonable. However, if the rule that the Housing Laws do not apply to leases made before the statute is upheld, reasonable value can be taken as that amount which average property of a similar kind was worth before their passage. Assessed value has also been suggested as the reasonable value, but it has been objected that assessed value is higher than reasonable value.

In conclusion, it should be noted that if the rate is computed correctly, it is immaterial whether the equity or the reasonable value be taken as the base. Much time and confusion would have been saved, however, if in the first case involving this question the ratio above mentioned had been determined, the reasonable rate on the equity fixed, and from this, the corresponding rate on the reason-

[8] It has been argued that the greater the mortgage the greater will be the owner's risk. This seems incorrect. For example: Suppose A and B each own identical apartment houses of the present value of $100,000. A has given a mortgage of $60,000 while B one of $40,000. If the value of the property decreases $20,000 both A and B lose the same amount. A's equity has decreased to $20,000; B's to $40,000.

able value computed. Thereafter it would only be necessary to determine the reasonable value and then use the rate so found in reaching the decision.[9]

EFFECT OF BANK'S CREDIT TO PAYEE OF CHECK IN MISRELIANCE UPON STATE OF DRAWER'S ACCOUNT.—Usually money paid under a mistake of fact, paid in misreliance upon a right or duty, may be recovered back,[1] for the defendant is "under an obligation, from ties of natural justice, to refund."[2] And the "plaintiff, even if negligent, may recover if his act has not changed the position of an innocent defendant to his detriment."[3] Despite these underlying principles, several exceptions have gained a more or less firm foothold in the law, and have had their influence upon analogous situations. Reference is had, of course, to the doctrine that there is no recovery of payment on a negotiable instrument to a holder in due course where the drawee pays or accepts a forged bill,[4] nor where one is induced by a forgery of his own signature to pay.[5]

Where the plaintiff has paid money to or conferred a benefit upon the defendant in misreliance upon his duty to a third party, another element enters. If the defendant is an innocent purchaser for value, there should be no recovery.[6]

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[9] The necessity for determining the reasonable value cannot be avoided in either case. If the equity is used, you must first take the reasonable value and then subtract the amount of the mortgage to determine the value of the equity.

Attention has not been called to the public utility rate regulation cases. They are not analogies as the temporary character of the Housing Laws renders the economic situation thereunder, wholly different.

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[1] *Woodruff* v. *Claflin Co.* (1910) 198 N. Y. 470, 91 N. E. 1103; *State Savings Bank* v. *Buhl* (1901) 129 Mich. 193, 88 N. W. 471; *Continental Caoutchouc, etc. Co.* v. *Kleinwort* (1904) 90 L. T. (N. S.) 474; Woodward, *Quasi-Contracts* (1913) 10, 11, 12.

In the *Kleinwort* case *supra,* the court says, at page 476, in regard to a situation where the recipient has paid the money to a third person, that "it is clear law that prima facie the person to whom money has been paid under a mistake of fact is liable to refund." This seems to allow the recipient to prove that in fact he has not pecuniarily benefited since he has spent the money upon a luxury which, under other circumstances, he would not have procured.

[2] Lord Mansfield, in *Moses* v. *Macferlan* (1760) 2 Burr. 1005, 1008.

[3] *National Bank of California* v. *Miner* (1914) 167 Cal. 532, 140 Pac. 27; see *Hathaway* v. *County of Delaware* (1906) 185 N. Y. 368, 370, 78 N. E. 153; *State Savings Bank* v. *Buhl, supra,* footnote 1, p. 197; (1908) 8 COLUMBIA LAW REV. 404.

[4] *Price* v. *Neale* (1762) 3 Burr. 1354; see N. I. L. § 62.

[5] *Jones* v. *Bank* (1910) 144 Mo. App. 428, 128 S. W. 829; *contra, Welch* v. *Goodwin* (1877) 123 Mass. 71.

[6] *Moors* v. *Bird* (1906) 190 Mass. 400, 77 N. E. 643; *Walker* v. *Conant* (1888) 69 Mich. 321; Keener, *Quasi-Contracts* (1893) 77, 157; *cf.* the rights of an innocent payee who buys of a remitter. (1920) 20 COLUMBIA LAW REV. 749, 758.

In *Strauss* v. *Hensey* (1896) 9 App. D. C. 541 and in *Grand Lodge, etc.* v. *Towne* (1917) 136 Minn. 72, 161 N. W. 403, though the facts were similar to those in *Walker* v. *Conant, supra,* footnote 6, an opposite result was reached. The facts are as follows: By fraud T induces the plaintiff to loan him money on a forged mortgage. At T's request the plaintiff pays part of the money to the defendant to satisfy the defendant's claim on a prior mortgage likewise forged by T. In the *Strauss* and *Grand Lodge* cases the defendant was not regarded as a purchaser for value. The courts, especially in the later case, seem to view the transaction as an attempted novation. But it might be said that the defendant is a purchaser for value, since he surrendered his claim against the forger of the mortgage.

In *Lawrence* v. *American National Bank* (1873) 54 N. Y. 432, the plaintiff made an overpayment to the defendant of the supposed balance due from the plaintiff to a third party. The defendant was the creditor of the third party, and had given a discharge of this debt on the basis of the plaintiff's payment. The plaintiff was allowed to recover, the court holding that the defendant could avoid